

March 18, 2004

VIA: e-mail and first class mail.

Mr. Richard C. Annan  
Acting Director  
Program Development and Regulatory Analysis,  
Rural Utility Service  
USDA  
1400 Independence Avenue, Stop 1522  
Washington, DC 20250-1522

RE: Financing for Household Water Well Systems

Dear Mr. Annan,

We recognize that we missed the official cutoff for receiving comments on *Financing for Household Water Well systems* published in the February 10, 2004 Federal Register and that the Department is under no obligation to consider these comments. We offer them nonetheless in a good faith effort to assist the Department in thinking about how best to design the program.

Community Resource Group, Inc. is a multi-state nonprofit Community Development Financial Institution (CDFI) based in Fayetteville, Arkansas. For over 25 years, as part of the national RCAP network, we have worked closely with RD offices across a seven state service area and currently provide on-site technical assistance to over 600 small water and wastewater systems annually.

In 1991 we were awarded a \$1 million IRP loan that launched our small system water and wastewater loan program that has grown to provide in excess of \$9.3 million in loans to over 167 small systems. **In addition to our public water system lending** we have for the past six years, using funds from the Wal-Mart Corporate and Ford Foundations, operated a consumer loan program for individual wells, septic tanks, and hooking up to public water supplies. We also have made over 500 consumer loans for home improvements in the Texas border colonias over the past several years.

We are pleased to have the opportunity to provide RUS with early input related to the implementation of the above titled program. Our comments are based on (1) our first hand knowledge of what it takes to successfully market, originate and service consumer loans to low-income borrowers; (2) our 25 years of experience working to insure that low-income families across the rural South have access to safe, affordable, and uninterrupted supplies of drinking water; (3) 14 years successfully lending for water facilities under the IRP program.

In the Federal Register, RUS requested comments and discussion on seven (7) topics. Our comments are similarly organized in response to each topic along with some general comments for your consideration.

1. Based on our experience with household and small community water and wastewater lending and experience providing technical assistance to small water systems across the South we offer the following comments.
  - a. Loans for household water systems are a type of consumer lending. Consumer lending laws and regulations, and lender licensing varies from state to state. It will be important to have prospective nonprofit lenders outline their strategy for complying with a state's consumer lending laws before engaging in loan making in that state. Given the relatively small amount of grant funds available (\$1 million) for loan capital we would expect a total of less than 200 loans to be made. Assuming a national program the relative cost of complying with individual state consumer protection laws will be considerable and should be addressed by nonprofit applicants as part of the application process.
  - b. Provision should be made to insure that loans under this program are not competing with the USDA 504 Home Improvement Loan Program that can also be used for constructing individual household wells. Further, RUS may want to consult with RHS/USDA regarding their experience with lending for individual water wells.
  - c. Loans for individual household wells should not undermine RUS's long-standing commitment to protect the public health by financing the construction of public water systems. Nonprofit lenders should be required to certify prior to making a loan for a household water system that:
    - (1) Connection to a public water system is not a current or near-term economically viable option, i.e., the total cost of the household water system (well, pumps, treatment, service lines) should, at a minimum, not exceed the cost of hooking up to a public water supply.
    - (2) The loan for a water well is not for the purpose of disconnecting a household from a public water supply that is in compliance with the Safe Drinking Water Act as amended.
    - (3) The borrower lives or will have its primary residence on the property where the financed water system is located and borrower has title to the property.
    - (4) The amount loaned plus borrower provided and other funds are sufficient to construct a complete household water system capable of delivering safe water to protect the family's health.

- d. The ability to provide objective, onsite **technical assistance** prior to originating the loan is a key component of successful lending. The application process should require nonprofit applicants for RUS grant funds to outline their strategy for providing technical assistance to prospective borrowers to insure that:
    - (1) The wastewater disposal issues created by the installation of a household water system are addressed.
    - (2) The overall cost of the project is reasonable and that competitive bids or price quotes have been obtained from reputable/licensed installation firms.
    - (3) The components of the proposed household water system and the system as a whole can reasonably be expected to deliver an adequate, uninterrupted supply of potable drinking water for the household.
    - (4) If a well is to be drilled there is a reasonable likelihood of obtaining an adequate supply of water. (It's difficult to get borrowers to pay off a loan for a dry hole.)
  - e. Experienced lenders understand that it is relatively easy to make loans—the challenge is in collecting them. The RUS application should require nonprofit applicants to outline their loan-marketing strategy, loan-origination mechanism, underwriting criteria/process along with their loan-servicing approach and loan write-off provisions.
  - f. The issue of whether or not the loans are to be secured by a real estate lien should be addressed either in the regulations or by the nonprofit applicants. If a lien is taken, we recommend that loan payoff be required at time of sale.
  - g. The 20-year loan term should be considered a maximum. In general the term of the loan should be tied to the expected useful life of the system components and the borrower's income/repayment ability. Loan underwriting should also consider borrower's ability to cover cost of system operation (electricity, purification chemicals, etc.) as well as repairs and component replacement in case of breakdown.
  - h. If a single applicant is selected to operate the program, provision should be made to insure that the nonprofit has a reasonable plan for rolling out a national delivery system over time to insure that lending is not limited to 1-2 areas of the country while excluding others.
2. While generally supportive of the matching-fund concept, we would point out that **the purpose of matching funds is seriously undermined if federal funds**

**awarded for use as loan capital or match funds are allowed to be used to pay administrative costs.**

- a. From a nonprofit applicant standpoint it is often easier to raise local match for loan capital than to raise funds to cover administrative/operating costs. RUS should consider taking the position that if it provides \$1 million in loan fund capital to a nonprofit grantee, it expects the grantee to have \$1 million either lent out or available for lending for a period of *X* years. This “a dollar is a dollar” approach gives the nonprofit the flexibility to raise funds to cover the cost of administration or for loan capital if it is easier. In either case an amount equal to the federal grant is available for lending for household water systems. This approach also allows RUS to objectively measure applicants offering loan capital match but proposing to use federal grant funds to pay for administration with applicants offering to cover all or part of the administrative cost but offering less or no loan capital match.
  - b. RUS should consider requiring grantee to agree to deploy the full amount of initial loan capital (including matching loan capital) within a negotiated period of time and to maintain an agreed-upon average level of deployment of loan capital. Average deployment would be calculated on a rolling 12-18 month period. This insures that the federally supported program is fulfilling the purpose for which it was funded.
  - c. Loan-loss reserves and loan losses should come from interest earnings, loan fees and local matching funds---not from federal dollars.
  - d. The nonprofit should be allowed to use the matching loan funds they provide for loans to eligible households for septic tanks, connection to a public water supply, sanitary sewer hookups and related purposes in order to provide a more comprehensive set of options and better protect the public health.
3. **The amount of RUS provided loan capital deployed by a nonprofit in a specific deal should be tied to the amount of match provided by the nonprofit.** If the nonprofit provides 25% match for loan capital then federal funds would be limited to 75% of the total project cost (not 75% of the total loan). The remaining 25% of the project cost would have to be covered at the nonprofit’s discretion from either their own funds or borrower financial participation in the cost of the project. This approach is designed to **encourage but not require the borrower to contribute funds** to the cost of the project while at the same time enabling the project to go forward even if the borrower is financially unable to participate up front, provided the nonprofit is willing to assume the additional financial risk resulting from no upfront participation from the borrower.
4. a. See 2(a.) above.

- b. Applicants should be allowed to charge interest and fees on the loans made under this program. Interest and fee earnings should be used to fund appropriate loan-loss reserves and to cover operating expenses or increasing loan capital. Our experience is that the market will dictate what can reasonably be charged if one desires to deploy the loan capital. Rather than dictating what fee amounts can be charged, **RUS should focus on setting standards for initial and ongoing deployment of the loan funds.** If the fees associated with borrowing are too high the market will decline to borrow and deployment will suffer.
  - c. Ultimate borrowers should be allowed to include loan fees in amount borrowed.
  - d. RUS should retain the right to **recapture all grant funds not initially deployed within the time set for initial deployment** and require an 18-month rolling average deployment rate of at least 60-70% be maintained for a 10 year reporting period. The need to deploy the funds will keep interest rates reasonable and in line with the market.
  - e. If RUS allows administrative costs to be an eligible grant cost, administrative costs should be calculated on a per-loan basis regardless of size since it takes the same time/effort to process and service a \$500 loan as an \$8,000 loan.
5. Our success as a lender is tied to our ability to stay close to our borrowers and be ready to step in quickly in times of trouble. Moving servicing of relatively small loans to a third party that does not have the capacity for timely intervention would increase the transaction cost while reducing the timeliness of needed intervention. We oppose the *required* use of the Central Servicing Center given the small size of each transaction and the relatively small number of loans that can be made given federal funds available.
  6. Recommend that borrowers with incomes below 80% of the state non-metro median income be exempt from having to demonstrate they are unable to obtain commercial credit at reasonable rates and terms. Further, grantees committing to lend a high percentage of available capital to applications from families below 80% or 50% of the state non-metropolitan median income should be awarded additional points in order to encourage targeting of limited resources to the poorest families.
  7. **Eligible loan purposes** should include:
    - Necessary hydrological studies
    - Drilling and casing the well in accordance with state/local regulations
    - Permits and inspections
    - Water pumps
    - Pressure tanks
    - Equipment to purify and/or improve taste, odor, or color of water

Installation of all equipment associated with household water system

Cost of extended warranties

Service lines from well to house

**INELIGIBLE Items include:**

Water lines (plumbing) inside home

Plumbing fixtures—sinks, faucets, toilets, etc.

Labor and other costs associated with ineligible items

**8. Other Comments.**

- a. From an economic standpoint RUS would be better off placing the funds with an existing consumer lending or rural water system loan program where the administration would represent a marginal cost rather than having the grant dollars consumed covering the startup and ongoing cost of a stand-alone program restricted to household water system lending.
- b. No limit or preference should be placed on the **size of the service area** proposed by an applicant. The appropriateness of the service area should be evaluated based on the applicant's lending capacity and proposed system for loan origination and servicing loans in the proposed service area. The ultimate goal should be to provide low-income householders nationwide, who cannot economically be served by a public water system, with access to financing for a household water system.
- c. While individual household water systems have a place in meeting the needs of rural families, RUS's massive financial support for rural public water systems suggests that historically the department has viewed public water systems as the preferred approach to protecting the public health of rural families. Given the small amount of funding for this national program, the transaction costs for small consumer loans, and the 20-year repayment term, few families will benefit each year following the initial deployment of funds. RUS should consider the federal funds granted under this program to have served their federal purpose and consequently lose their federal identity once the initial grant funds have been lent to eligible borrowers. This is done in the IRP program. This would allow grantees (with concurrence from RUS) to use revolved funds to broaden subsequent loan purposes to include septic tanks, hookups to public water systems, and other support for public water systems, and to modify interest rates and terms.
- d. When USDA makes a low-interest loan to a nonprofit intermediary for relending under, for example, the IRP program, the 30-year loan term defines the length of the relationship. Once the loan is repaid the relationship is cleanly terminated. However, under this program, grants for loan capital are

given, but the term of the relationship is unclear. We would urge RUS to clarify the following:

What is the reporting period for these grant funds?

At what point do they cease being federal funds and become an asset of the nonprofit lender?

For what period of time must the nonprofit continue to use the grant funds for the purpose granted?

We would recommend that if the nonprofit recipient of RUS grant funds under this program, meets initial and ongoing deployment levels for some period of time (perhaps 10-15 years) while maintaining the same level of loan funds as originally granted (including cash match), then the funds should be considered to have met their federal purpose and become the sole property of the nonprofit.

These comments on the *Financing for Household Water Well Systems* are submitted by Community Resource Group, Inc. If you have questions would like to discuss further, please do not hesitate to call.

Sincerely,

John Squires  
Executive Director